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Foreign Economic Trends and Their Implications for the United States

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KOREA

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KOREA KEY ECONOMIC INDICATORS

Unless otherwise indicated, all values are in current \$U.S. Million and represent period averages.

Exchange Rate: US\$1.00=713.3 won

As of November 27, 1990

Exchange Rate: US\$1.00=713.3 won	Percent Change					
As of November 27, 1990	1988	1989	1990	1988	1989	1990
INCOME, PRODUCTION, EMPLOYMENT						
GNP	172,784	210,114	233,847	19.1*	11.8*	17.2*
GNP at Constant (1985) Prices	128,634	137,313	149,671	12.4*	6.7*	9.0*
Per Capita GNP (\$)	4,127	4,968	5,477	17.9*	10.6*	16.1*
Indices: 1985=100						
Industrial Production	166.1	170.5	185.8	13.8	2.6	9.0
Avg. Labor Productivity	154.2	172.5	194.9	14.6	11.9	13.0
Avg. Industrial Wage	145.8	182.3	215.1	19.6	25.1	18.0
Labor Force (Thous.)	17,305	17,975	18,514	2.6	3.9	3.0
Avg. Unemployment Rate (%)	2.5	2.6	2.5	-	-	-
Total Population (Thou. Mid-year)	41,975	42,380	42,793	0.96	0.97	0.98
MONEY AND PRICES						
Money Supply (M2) ^{1/}	71,537	86,283	98,413	21.5*	19.8*	20*
Interest Rates (Comm. Banks)	13.0	12.5	12.5	-	-	-
Indices: 1985=100						
Wholesale Price	101.7	103.2	107.3	2.7	1.5	4.5
Consumer Price, all cities	113.4	119.9	130.7	7.1	5.7	9.0
GNP Deflator	112.7	118.0	126.3	5.9	4.7	7.5
BALANCE OF PAYMENTS AND TRADE						
Gold and FX Reserves (Official) ^{1/}	12,378	15,245	16,000	34.6	23.2	11.5
External Debt ^{1/2/}	31,200	29,400	31,500	-12.4	-5.8	7.1
Annual Debt Service ^{3/}	10,100	8,110	6,500	-42.6	-19.7	-19.9
Annual Debt Service Ratio (%) ^{3/}	14.2	11	9	-	-	-
Balance on Current Account	14,161	5,055	-1,700	-	-	-
Balance of Trade (FOB)	11,445	4,597	-1,300	-	-	-
Exports (FOB), Customs Basis	60,696	62,377	64,500	28.4	2.8	3.4
To U.S.	21,404	20,639	20,000	16.9	-3.6	-3.1
Imports (CIF), Customs Basis	51,811	61,465	69,500	26.3	18.6	13.1
From U.S.	12,757	15,911	17,000	45.7	24.7	6.8
Balance of Trade, Customs Basis	8,886	912	-5,000	-	-	-
With U.S., Customs Basis	8,647	4,728	3,000	-	-	-
Average Exchange Rate (Won/US\$) ^{4/}	730.6	671.4	707	-11.2	-8.1	5.3
Period-End Exchange Rate (Won/US\$) ^{4/}	684.1	679.6	715	-13.7	-0.7	5.2

Major imports from the U.S. in Jan-June 1990 (in US\$ Mil., CIF): Machinery (1,692), Electronics & Electrical Equipment (1988), Chemicals & Chemical Related Products (\$779), Grains (575), Iron & Steel Products (521), Raw Hides & Skins (470), Pulp & Paper (413), Raw-hide Cotton (298), Aircrafts (267), Logs & Wood (256), and Soybeans (99).

Major exports to the U.S. in Jan-June 1990 (in US\$ Mil., FOB): Electronics & Electrical Equipment (2,047), Textiles (1,379), Footwear (1,244), Machinery (1,030), Automobiles (442), Iron & Steel (476), Toys (221), Luggage & Handbags (212), and Tires & Tubes (115).

FOOTNOTES: *Percentage changes calculated in won terms. ^{1/}Data are for end of period. ^{2/}All external debt including debt of under one year maturity. ^{3/}Includes interest payments on debt of under one year maturity as a percentage of total exports of goods and services.

SOURCE: Embassy estimates, Bank of Korea, Economic Planning Board and Ministry of Finance.

*OVERVIEW AND OUTLOOK

Following unexpectedly large and rapid adjustments in real GNP and export growth in 1989 -- GNP fell from average annual growth of over 12 percent between 1986 and 1988 to a more sustainable 6.7 percent, and exports declined in real terms for the first time since 1979 -- the Korean economy in the first part of 1990 returned to close-to-double digit expansion. Real GNP grew by 9.8 percent and exports, by 5.2 percent in real terms in the first three quarters. Investment also continued strong, increasing by 24.5 percent over the same period of 1989. The labor scene was noticeably calmer this year than in the previous four years, with the number of labor disputes and production and export losses stemming from labor unrest dropping markedly. Unemployment averaged a low 2.5 percent through September. Manufacturing industries experienced a labor shortage and called for the government to allow an inflow of foreign workers.

In light of these developments, the cries of "crisis" which characterized the economic scene last year have abated. The Government of the Republic of Korea has revised upwards its projections for growth in 1990. The Economic Planning Board now expects growth of 9.2 percent, while the Korea Development Institute and the Bank of Korea project 8.6 and 8.8 percent growth, respectively. This is in the range of Korea's average growth rate of 8.3 percent over the past 10 years and its potential growth rate, estimated by the Bank of Korea, of 8.2 percent.

Currently, inflation is the main challenge to continued strong economic performance. Consumer prices rose at an annualized rate of 9.9 percent through November. The ROKG is aiming to hold inflation below 10 percent for the year. Among other potential negative effects, rapidly rising prices may erode the relative calm that has prevailed on the labor front this year. However, the government faces a dilemma in taking decisive steps to deal with inflation. The monetary and credit restraint necessary to slow inflation will worsen the current credit crunch and slow the economic recovery. Business groups have already called for an increase in the money supply to ease financing difficulties. Until late November, the government insulated the economy from the effects of increases in world oil prices through its petroleum stabilization fund. However, on November 24, the government allowed gas and kerosene prices to rise by 28 percent (while still maintaining the domestic prices of petroleum products used primarily by industry).

Despite a performance which continues to be strong by international standards, ROKG economic policymakers remain preoccupied with the fragility of the economic recovery. They are particularly concerned that consumption and construction, growing at 10 and 28 percent respectively in the first nine months, were key sources of the strong growth

*This report was written in December 1990.

experienced thus far this year. The government views construction and consumption as unstable bases for longer term growth and expects both to moderate towards the end of 1990, slowing the rapid pace of GNP expansion to 7.5 percent for the second half. Third quarter upsurges in manufacturing and exports, viewed by many Koreans as the only sources of real and sustainable growth, have alleviated these concerns somewhat. At the same time, however, growing domestic demand diversifies Korea's sources of growth, insulating the economy somewhat from external shocks which disrupt export markets. In fact, since the last quarter of 1988, burgeoning domestic demand has been the main source of economic growth. The active construction sector is also addressing pressing infrastructural needs, especially the demand for housing.

ROKG planners are also extremely concerned that for the first time since 1985, Korea's current account posted a deficit of \$1.3 billion through October 1990. Growth in exports, while improving, remains moderate by Korean standards. Imports, on the other hand, are growing rapidly. These trends are likely to continue. Recent exchange rate developments, particularly the stronger yen, have given Korean exports a boost. However, analysts agree that export prospects over the longer term depend on industry's efforts to make the adjustments needed to regain competitiveness lost with the wage increases, labor unrest, and exchange rate changes of the past few years. Stabilization of labor management relations, research and development of high technology, and a shift to more capital-intensive, higher value added production are critical factors. Relatively strong growth in imports will continue to be fuelled by the need for raw materials and capital goods essential to industrial adjustment, improving the infrastructure and increasing exports. The likely return to a deficit in 1990 (which the government expects will rise to \$2 billion in 1991 before the current account shifts back to balance in 1992 and a surplus of \$1 billion in 1993) raises the prospect of renewed external borrowing. Net foreign debt began growing again in 1990, for the first time since 1985.

Developments in the international economy in 1990 and in 1991 may exacerbate these problems. Korea depends on imported oil to meet 60 percent of its energy needs. Increases in the price of oil related to the situation in the Gulf will raise the import bill. A slowdown or recession in Korea's developed country markets, particularly the EC and the United States (which together took 45 percent of Korea's exports in 1989), will lead to further deterioration in the trade account. Failure to reach meaningful agreement in the Uruguay Round, with the attendant risk of a return to bilateralism in resolving trade differences, would also hit trade-dependent economies like Korea's hard (exports of goods and services accounted for 38 percent of GNP in the first nine months of 1990).

Concern with the decline in exports and the deterioration in the external accounts resulted in a shift in economic policy in early 1990. Emphasis on internal reform and internationalization gave way to a renewed focus on growth and exports. In this environment, new efforts to liberalize the economy appear to have been put on hold. Furthermore, complications in implementing previous bilateral agreements have developed. An austerity campaign has emerged, which the government maintains is a spontaneous and privately generated demonstration of Korea's traditional Confucian values of frugality and thrift. The United States has indicated to the ROKG that whatever its origins and purposes, an anti-import bias is inappropriate to a country of Korea's economic standing, and measures perceived to be aimed at hindering imports will be met with a strong response. The United States will continue to work with the Korean Government for full implementation of existing agreements and continued progress by Korea in providing meaningful market access for U.S. exporters and investors.

POLITICAL SETTING

Korea's gradual democratization process continued in 1990. The political scene, which in 1988 and 1989 had been preoccupied with investigations of Korea's previous governments, entered a period of reorganization of political parties. In January President Roh's party merged with two of the three opposition parties. The resulting Democratic Liberal Party (DLP) controlled more than two-thirds of the seats in the National Assembly. A splinter group of assemblymen formed the Democratic Party (DP). The DLP then entered a period of confrontation with the opposition parties.

In July the DLP passed several controversial bills in an up-down vote in the Assembly, prompting the opposition Assemblymen to submit their resignations in protest and demand immediate assembly elections. The resignations were not accepted, however, and the ruling party appealed to the opposition to continue participation in the Assembly. By early September, the DLP and the opposition began talks on restoring normal Assembly operations. The opposition returned to the Assembly in late November. Key political issues in 1991 will include local elections and possible constitutional revision to replace the current direct presidential system with a parliamentary cabinet system.

The 1990 labor-management negotiating round passed rather quietly, due to fears of declining international competitiveness which led to a strong government drive to keep wages from rising. The government continued its crackdown on dissident labor groups, which banded together in January to form a national organization called "Chonnohyop." After three years of rapid growth, real wages showed little growth during the first eight months of 1990.

KOREAN ECONOMIC TRENDS

Macroeconomic Performance: Korea's real GNP grew 9.9 percent (GDP 9.5 percent) in the first half of 1990 over the same period of last year. The 9.9 percent growth is an improvement over the 6.8 percent growth registered in the first half of 1989 and is higher than the 7-8 percent growth rate predicted by the Bank of Korea (BOK). The BOK attributed the impressive GNP growth in the first half primarily to an increase in manufacturing output (up 8.1 percent) and construction (up 30.6 percent). Economic growth was also driven by increased private consumption (up 11.1 percent) and fixed investment (up 27.3 percent). Exports, historically the engine of economic growth, grew 2.7 percent in real terms for the first half this year, an improvement over the 4 percent negative growth recorded in the same period of last year.

The unemployment rate fell to a record low of 2.1 percent during the second quarter of 1990. The unemployment rate for the first half of 1990 remained unchanged from the 2.6 percent recorded in the first half of 1989. Many Korean manufacturing firms are experiencing difficulty finding skilled workers. The services sector increased its share of the work force, from 50.8 percent in the second quarter of 1989 to 53 percent in the second quarter this year, largely at the expense of primary and secondary industries. Monthly wages for all industries averaged 540,805 won in 1989, up 21.2 percent from the year before, the highest increase since 1981. Wages in the manufacturing sector for the first four months of 1990 increased 24.9 percent over the same period last year, nearly equivalent to the 25.1 percent rise recorded in 1989. However, wages at businesses with 100 employees or more rose an average of 8.9 percent as of the end of July 1990, a decrease from the 18.7 percent rate of increase recorded in July 1989. Average working hours per week including overtime dropped to 49.2 hours from 51.1 hours in 1983.

Labor disputes declined this year; labor disputes occurring at of the end of July 1990 numbered 276 compared with 1,237 for the same period last year. Production losses and export losses due to labor disputes declined 57 percent and 73 percent respectively.

Consumer prices increased 8.2 percent in the first eight months of 1990, while wholesale prices rose 4.1 percent. The Economic Planning Board attributes the inflation to increases in wages and the value of real estate, and to price increases in services and agricultural products. The upsurge in prices appears to have been sparked by the Bank of Korea's December 1989 release of some 2.4 trillion won (\$3.4 billion) to support the tumbling stock market, which had entered a period of correction after growing by some 500 percent between 1985 and 1989. The market has fallen by 24 percent in the first

11 months of 1990, stabilizing at about 680 in November. Interest rate cuts encouraged by the government in July in an attempt to ease credit and continued rapid growth in the money supply have exacerbated the problem, as did increases in agricultural prices earlier in the year resulting from shortages following the September flood. The government had originally hoped to limit inflation this year to 5-7 percent for consumer prices and below 2-3 percent for wholesale prices. In June it revised its expectations, aiming to keep consumer price increases below 10 percent for 1990.

Rising real estate prices and the falling stock exchange attracted attention from both the government and the public in 1990. According to the Shinhan Research Institute, land prices rose 14.7 percent in 1987, 27.5 percent in 1988, and 31.9 percent in 1989. The stock market's composite index closed 1989 at 910, and fell below 600 in August 1990. On May 8, 1990, the Deputy Prime Minister announced a set of special supplementary measures aimed at curbing real estate speculation and achieving price stability. These measures required the largest Korean conglomerates and financial institutions to dispose of their non-business related real estate holdings and to refrain from acquiring new properties. The following day, the Minister of Finance announced measures for stabilizing the stock market; namely, the inauguration of a 4 trillion won (\$5 billion) stock market stabilization fund.

Fiscal and Monetary Policy: The total money supply (M2) increased 22.7 percent during the first seven months of this year over the same period of last year. The M2 growth rate is 4.1 percentage points higher than the 18.6 percent registered in the corresponding period of last year. According to the Economic Planning Board, increased funds used for purchasing rice and boosting the stock market precipitated the growth in money supply. In line with the Economic Management Plan, the government aims to hold the annual growth of M2 in 1990 to 19 percent. However, M2 growth for 1991 is likely to be managed "flexibly", possibly exceeding the 20 percent level to ease the lack of liquidity in the money market. During the first seven months of 1990, the Bank of Korea has issued won 14,151 billion (\$20.2 billion) worth of Monetary Stabilization Bonds (MSB). But, its repayments in the same period amounted to won 14,996 billion (\$21.4 billion), exceeding the issue by won 845 billion (\$1.2 billion). The value of MSB's outstanding totalled won 16.5 trillion (\$23 billion) at the end of July this year, equivalent to 27 percent of M2 outstanding.

Balance of Payments and Foreign Debt: In the first seven months of 1990, Korea posted a current account deficit of \$1 billion, the first time since 1985 that Korea has registered a current account deficit. Due to a combination of sluggish exports and increased imports, the trade account totalled a \$0.9 billion deficit on a balance-of-payments basis during the

first seven months of 1990; in the same period of 1989, the trade account posted a \$2.5 billion trade surplus. Imports during the period grew 10.7 percent on a customs clearance basis. The growth in imports was led by a 19 percent rise in imports of capital goods, a reflection of the 20 percent (in real terms) increase in investment in domestic plant and equipment reported by the BOK. Korea's trade surplus with the United States declined during the first seven months of 1990, but the trade deficit with Japan widened. The trade surplus with the United States fell to \$1.2 billion in the period, down 53 percent from the same period last year. Korea's trade deficit with Japan during the period totalled \$3.4 billion, up 48 percent from the corresponding period last year. ROKG foreign exchange reserves reached \$15.6 billion at the end of July, up \$0.4 billion from the end of 1989. The government has revised its estimate of Korea's current account deficit in 1990 to \$1-\$1.5 billion from the \$2 billion surplus projected at the beginning of the year and \$1 billion deficit projected in the mid-year Economic Management Plan.

In the first quarter of 1990, Korea's gross and net foreign debt began to increase for the first time since 1986. As of the end of March 1990, gross foreign debt stood at \$29.41 billion, up \$40 million from the end of 1989. The increase was due primarily to a rise in short-term debt. Korea's foreign assets during the quarter decreased to \$25 billion, down \$1.34 billion since the end of 1989. As a result, Korea's net foreign debt totalled \$4.39 billion at the end of March, up \$1.38 billion from the \$3.01 billion at the end of 1989. The increase in net debt is due mainly to a drop in foreign assets. The government has also allowed local banks to borrow, in aggregate, up to \$2 billion abroad -- the first time that such borrowing has been permitted since 1986. The continued expansion of the trade deficit indicates that Korea is unlikely to acquire net creditor status this year.

Exchange Rates: As of September 3, 1990, the won had depreciated against the U.S.dollar by 2.7 percent since March 2, 1990 (the date the "market average rate" exchange rate system was implemented) and 4.7 percent since the end of December 1989. The Korean won appreciated four consecutive years during 1986-1989; 3.3 percent in 1986, 8.7 percent in 1987, 15.8 percent in 1988, and 0.7 percent in 1989. Between September 1985 and September 3, 1990, the won appreciated 25 percent against the U.S.dollar. During the first eight months of 1990, the won depreciated 4.9 percent against the Japanese yen, after appreciating 17.3 percent in 1988 and 16 percent in 1989. From December 31, 1989 to September 3, 1990, the won's depreciation against major European currencies ranged 11.2-19.2 percent. The daily volume of interbank transactions between March 2, 1990, and the end of August ranged from \$165 million to \$232 million, averaging \$193 million.

The Ministry of Finance introduced a new "market middle rate" exchange rate system in March 1990 as a transitional step before its scheduled implementation of a freely floating exchange rate sometime after 1992. Under this new system, the daily won-dollar average exchange rate is determined on the basis of the prevailing inter-bank rate and foreign exchange transaction volumes on the previous day. The value of the won vis-a-vis other foreign currencies is calculated on the basis of foreign currency/dollar rates in the international market.

Foreign Investment: Foreign investment approvals and arrivals picked up slightly in 1990, after declining in 1989. During the first six months of 1990, both investment approvals and arrivals increased by about 5 percent over the same period of the previous year, reaching \$470 million and \$458 million respectively. 1989 saw a drop of 15 percent in approvals and 9 percent in arrivals from 1988 levels. In contrast to previous years, 1990 approvals of investment from the United States (\$181 million) surpassed those from Japan (\$159 million). New investments approved in 1990 tended to concentrate in the manufacturing sector, particularly in chemical industries. The U.S. and Japan account for approximately 70 percent of all foreign investment in Korea.

The ROKG continued to revise foreign investment-related regulations to ease entry conditions on the one hand and restrict projects eligible for tax holidays on the other. In addition to the liberalization of certain sectors for foreign investment in 1989, including advertising and pharmaceuticals, the ROKG, in accordance with the super 301 agreements reached in May 1989, liberalized cosmetics and toiletries effective July 1, 1990. The ROKG also raised the ceiling for automatic approval of minority-invested manufacturing projects (involving no tax holiday) from \$3 million to \$100 million as of January 1, 1990, effectively eliminating the investment approval requirement for this category of investment.

Effective January 1, 1990, the ROKG revised the criteria for exemption/reduction of income and other taxes for foreign investors, enumerating 42 individual subsectors eligible for tax exemption. All of them are advanced technology sectors. The ROKG announced in July 1990 that it will revise the Foreign Capital Inducement Act, the basic law governing foreign investment. The revision will require foreign investors only to report projects, rather than obtain Ministry of Finance approval for certain industries. The new law will also reduce the size of tax holidays and narrow the eligibility criteria for tax holidays. For example, the income tax reduction will be scaled down from the present 100 percent exemption for five years to 100 percent for the first three years and 50 percent for the next two years.

Foreign investors, as did domestic investors, have benefited from the reduction in labor disputes this year. However, they are beginning to experience a shortage of skilled and unskilled labor, prompting calls from Korean industry for foreign workers to be allowed into Korea. Continuing difficulty in obtaining adequate financing also complicates foreign operations in Korea.

Merchandise Trade: Korea's trade deficit for the first six months of 1990 totalled \$2.8 billion, as opposed to the \$81 million surplus registered in the same period last year. Korean merchandise exports for the first half of 1990 totalled \$29.8 billion, an increase of 2 percent over the same period last year, while Korean imports worldwide rose 12 percent to \$32.5 billion. Korean economic analysts attributed the slowdown in exports to Korea's diminished competitiveness in international markets, continued labor unrest, the large wage increases of the past several years, Won appreciation and recent yen depreciation against the U.S. dollar. Nevertheless, total exports accounted for 38.6 percent of the nation's GDP in the first half of 1990.

Korea's bilateral trade surplus with the United States for January-June 1990 narrowed 63 percent from the corresponding period last year, dropping from \$2.4 billion to \$896 million in 1990. Korean exports to the United States in the first six months of 1990 fell 5 percent to \$9.2 billion; imports from the United States during the period increased 13 percent, reaching \$8.3 billion. During the first half of 1990, the United States remained Korea's largest overseas market, taking 31 percent of Korean exports worldwide. The United States accounted for 26 percent of Korean imports, up slightly from the 25 percent during the same period last year.

Korea's trade deficit with Japan widened to \$2.9 billion, a 42 percent increase over the same period in 1989. The Japanese share of Korean imports, however, fell from 28 percent in the first half of 1989 to 26 percent this year. Korean exports to Japan during January-June 1990 fell 9 percent to \$5.6 billion. Korea's trade balance with the EC registered a \$0.3 billion deficit as opposed to a \$0.4 billion surplus in January-June 1989.

Korea's two-way trade with the socialist countries during the first half of 1990 totalled \$2.4 billion, or 4 percent of Korea's worldwide trade. Korea's trade balance with socialist countries, which suffered a deficit of \$30 million at the end of five months, improved to a surplus of \$5 million by mid-year 1990; exports to socialist countries were up 28 percent over the first half of 1989, with Soviet-bound exports increasing 774 percent. Total imports from the socialist countries increased by only 7 percent.

Imports of raw materials accounted for 54 percent (\$17 billion) of total imports, a 7 percent increase over the same period last year. Raw materials imported for domestic use increased 18 percent to \$18.3 billion, while those targeted for exports increased 1 percent. Imports of capital goods in the first six months of 1990 increased 20 percent over the same period of 1989, accounting for 36.6 percent of total Korean imports. Imports of capital goods from the United States during the reporting period increased 16 percent totalling \$3.5 billion. Imports of consumer goods, including grains, made up only 9.6 percent of total Korean imports. Automobile exports to the United States experienced a sharp decline during January-June 1990, falling 46.9 percent from the same period in 1989.

Protection of Intellectual Property Rights: In 1987 the Korean government enacted laws which significantly improved protection for copyrights, patents and trademarks. Although American companies have benefited from these improved laws, the U. S. Government remains concerned that Korean enforcement efforts continue to be inadequate. Piracy of computer software and video tapes persist, and counterfeit merchandise is readily available in Korea's stores. In addition to monitoring Korean enforcement efforts the US Government also is encouraging the ROKG to extend protection to semiconductor mask works and to enact an effective trade secrets law.

Textiles and Footwear: Korea's textile export goal of \$15.7 billion will be difficult to achieve as the export forecast for the latter half of the year is gloomy. The 1990 textile export goal is to increase exports 4.7 percent over 1989. Textile exports during the first half of 1990 decreased 2 percent over the same period of 1989, totalling \$5.8 billion. Letter of credit (L/C) arrivals dropped 8 percent to \$6.6 billion during the first six months of this year. Korea's textile exports accounted for 20 percent of total Korean exports for the first six months of 1990, the second largest category of exports after electronics. Textile exports to the United States totalled \$1.4 billion during the first six months of 1990, a 9 percent decline over the same period of 1989. Textile exports to Japan also dropped sharply, falling 27 percent from \$1.4 billion in the first half of last year to \$1.1 billion in the corresponding period this year.

Exports of textile machinery during the first half of 1990 increased 12 percent over the same period of 1989, totaling \$104 million. This increase is largely due to growth in exports to the Philippines, Indonesia, Saudi Arabia and the United Arab Emirates. A number of Korean cotton spinners and weavers have reportedly purchased futures contracts in raw cotton through U.S. dealers to hedge against price fluctuations. Domestically, sales of women's high-fashion casual wear and sportswear with internationally famous brand names (imported trademarks) continued to boom. The labor

intensive textile industry in Korea has been greatly affected by wage increases, won appreciation, and international competition from lower wage countries. As a result, Korean textile manufacturers have increased overseas investments. During the first half of 1990, Korea's textile industry made 48 investments offshore totaling \$114 million, mainly to Southeast Asia (36 cases) and the Caribbean Basin (10 cases). One company, Jin Ung Co., Ltd., invested \$200,000 in the United States for tent manufacturing.

After experiencing a slump in 1989, the Korean footwear industry is currently enjoying improved sales abroad. Average worldwide shoe prices went up nearly 20 percent during the first half of this year. Newly developed pump-sole shoes are popular in overseas markets. Exports of leather sports shoes accounted for 60 percent of the total footwear exports during the first half of 1990. Footwear was Korea's sixth largest export product during the first six months of 1990, totalling \$2.1 billion or 6.9 percent of all Korean exports, an increase of 23 percent over the same period last year. Industry analysts expect that Korea's footwear exports for this year will reach \$4.2 billion, up from \$3.2 billion in 1989.

Korean footwear exports to the United States increased 20 percent to \$1.2 billion during the first six months of 1990. Footwear exports to Japan increased 3.6 percent to \$204 million from the \$197 million reached in the first half of last year. Footwear exports to Canada and West Germany also increased, 43 percent and 37 percent respectively. According to unofficial data, Korean footwear exports to the Socialist countries, including the Soviet Union, totalled \$5.9 million during the first half of 1990 compared to \$83,000 for the same period of last year.

Agriculture: In the first six months of 1990, Korea's total imports of agricultural products fell 3 percent in value from the comparable period of 1989. Imports from the United States, however, rose 7 percent to \$1.7 billion. The overall decline can be explained by generally lower commodity prices. Demand remains strong for the basic bulk commodities: hides, cotton, and feedgrains. Imports of soybeans have slowed as feed millers are substituting soybean meal from the Peoples' Republic of China for whole beans from the United States or Brazil. The shoe and leather garment industries continue to be the world's leading customer for hides and skins, with imports from all origins reaching \$930 million in the first six months of 1990. Demand for corn was very strong as world prices were low and supplies abundant; imports from the U.S. rose 17 percent to \$410 million. Total cotton imports rose 8 percent to \$389 million, and the United States market share rose from 67 to 77 percent. Total wheat imports fell, as no feedwheat was imported in the first half of the year. This is expected to change later in the year.

Although bulk commodities continue to make up most of Korea's agricultural imports, the most rapid growth has been in consumer products. Imports of confectionary products, juices, and beef all are increasing rapidly.

Many products continue to face import restrictions or non-tariff trade barriers. The outcome of the Uruguay Round of GATT negotiations is being closely watched both by Korean producers and U.S. exporters. Despite government campaigns against "excessive consumption," rapid increases in income are increasing consumer demand for a wider variety of food products. Demand growth for most products is expected to remain strong.

Electronics: The deceleration of the Korean electronics industry which began in 1989 continued in 1990. For the first six months of 1990, Korean electronics output totalled \$13.5 billion, an increase of 9.9 percent, while exports reached \$8 billion, up 1.8 percent over the same period last year. 1990's performance contrasts with average annual production and export growth of 30-40 percent registered between 1986 and 1988. The reduced growth is attributed to rising labor costs, lack of innovative products, and to slowing demand worldwide.

Although exports to Japan were up by 25 percent and exports to EC countries recorded a moderate 5 percent growth, exports to the United States recorded their first ever decline, falling 13 percent. Industry analysts point to the poor showing of consumer electronics as prompting the decline; exports of video cassette recorders were down 51 percent, microwave ovens were down 33 percent and color TV's dropped 12 percent. Nevertheless, the United States remains Korea's largest market, taking 33 percent of all exported electronics.

During the first six months of 1990, industrial electronics and parts and components showed an increase in output and exports. Exports of semiconductors recorded a 17.6 percent growth, outpacing the other major products. Production remains concentrated in MOS memory devices: In June 1990, Korea started to produce a half-million 4 megabyte D-RAM chips per month, and plans to double output in 1991. Consumer electronics, on the other hand, showed a flat growth in output and a negative 11 percent growth for exports.

Shipbuilding: New orders for the first half of 1990 totalled 4.4 million gross tons (GT) (4.38 million GT of export ship orders and 14,000 tons of domestic orders), a 259 percent increase over the same period of 1989. This substantial rise in volume reflects replacement demand for large tankers which were constructed in the 1970s, accelerated orders of shipowners in expectation of further increases in ship prices, and U.S. implementation in the United States of regulations requiring double-bottom tankers.

The increase also reflects Japan's inability to deliver on new orders until 1991, and Soviet orders to Korean shipyards. In value terms, Korean shipyards received orders totalling \$3.5 billion, representing a gain of 188 percent over the same period of 1989. The growth rate in value terms lagged behind the growth in volume, reflecting that the major ships ordered for the first half of 1990 were less expensive tankers and combined carriers, which accounted for 91 percent of total order receipts, in contrast to last year's orders of higher priced ships.

Ship construction during the first six months of 1990 was 1.3 million GT, a 190 percent increase over the same period of 1989; an increase partly due to relatively stable labor-management relations. Orders booked as of the end of June 30, 1990, totalled 8.9 million GT, which is sufficient to keep Korea's shipyards occupied until the end of 1992. As shipyard capacity is booked through 1992, new orders for the remainder of 1990 will be screened based on profitability. Although demand softened in the third quarter, shipbuilders are confident they will achieve their 1990 targets of 5 million tons in orders as domestic orders of 250,000 GT and 400,000 GT will be placed in the second half of 1990 under the Bare Boat Charter (BBC) system. In April 1990, the government approved the BBC system allowing domestic shipping companies to use overseas funds in purchasing Korean ships. The government had banned this practice since 1987 in line with its monetary stabilization policies.

Construction: The construction sector grew a strong 61.7 percent during the first half of 1990 over the same period last year, fueled by a domestic construction boom. During the first half of 1990, orders for domestic construction totalled Won (W)10.9 trillion (\$15.2 billion). Partly as a result of government plans to supply two million new houses by 1993 and to construct two satellite cities outside Seoul, private sector construction grew 62.8 percent over the same period last year and totalled W6.8 trillion (\$9.6 billion). Orders from the public sector increased 51 percent over the same period of 1989 to W4 trillion (\$5.6 billion). Major public projects included west coast industrial complexes, regional development plans and transportation infrastructure.

Construction permits, a gauge of construction demand, rose to 56.8 million square meters, up 34 percent over the same period of 1989. Construction permits for residential use accounted for 54.7 percent of the total construction permits, compared to 49.4 percent during the same period of 1989. Commercial construction permits showed a growth rate of 26 percent over the same period of 1989, accounting for 31 percent of total permits. Industrial construction permits, which dropped 4 percent in the first half of 1989, grew 17 percent in the first half of 1990, boosted by the recovery of industrial facility investments.

The growth of construction for the second half of 1990 is expected to slow to about 26 percent (over the same period last year), largely due to raw material shortages, increased wages and costs of construction materials, postponement of several public projects, and governmental efforts to curb inflation by restricting issuance of commercial building permits. As a result, orders for domestic construction are expected to grow more slowly, reaching W21.8 trillion (\$31 billion) in 1990, up 38.7 percent over 1989. (1989's growth rate over 1988 was 58.7 percent.)

Overseas construction orders, boosted by the \$4.6 billion Libyan Man-Made River Project won by a Korean contractor in February 1990, rose 13 times over a year ago to \$5.4 billion for the first six months of 1990. Excluding the Libyan project, construction orders increased 97.5 percent to \$790 million over the first half of 1989's \$401 million. The Middle East accounted for 51 percent of the orders; during the first half of 1989, the Middle East market share was 60 percent (\$242 million). The Middle East's dominance with Korean construction orders has declined steadily since 1983 due to reduced oil revenues and Korea's loss of competitiveness. Korean construction firms have accordingly diversified away from the Middle East and into other Asian countries. As a result of these efforts, Asia's share of total overseas construction orders (excluding the Libyan project) rose to 34 percent during the first half of 1990, compared with 32 percent in 1989 and 6.1 percent in 1981. Construction orders from other regions, such as the U.S., Japan and EC, remain minimal due to restrictions on the use of alien workforce and the Korean construction companies' inability to provide financing or the latest technology.

In the second half of 1990, orders taken from abroad will be selected carefully as Korean companies shift their focus toward the domestic market and conserve limited manpower. Orders from abroad for 1990 are expected to total \$7.1 billion, lower than the original target of \$7.5 billion due to the volatile situation in the Persian Gulf.

Automobiles: The first half of 1990 continued last year's trends of sluggish exports and rising domestic demand in the automobile industry. Auto exports in the first six months of 1990 amounted to 125,282 units, a 32 percent decline from the same period in 1989. Exports as a share of total sales dropped to 22 percent during the first six months of 1990, from 37 percent a year ago. The U.S. market was the destination for 63,813 units during the first six months of 1990, a 47 percent drop over the same period of 1989, and the U.S. share of total Korean auto exports fell to 51 percent from 65 percent in 1989, and from a high of 83 percent of all exports in 1988. Exports are expected to recover somewhat in the second half of 1990, boosted by brisk shipments of Hyundai Motor's new "Scoupe"

model passenger cars and development of such new overseas markets as Eastern Europe. The Korea Automobile Manufacturers Association (KAMA) predicts 1990 auto exports will be 370,000 units, representing a 4 percent gain over 1989, but down from the original target of 420,000 units.

Domestic car sales for the first half of 1990 were up 37 percent over the same period last year, totalling 437,759 units. Commercial cars (trucks and special vehicles) increased sales by 40 percent over the first six months of 1989. Passenger car sales for the first six months of 1990 increased 36 percent over the first half of last year, totalling 284,214 units or 72 percent of the total market. The growth rate in passenger car sales is down from last year's 59 percent and will probably continue to decline due to the slowing economy and rising oil prices. KAMA estimates that domestic demand will equal 900,000 units in 1990, an 18 percent increase over 1989.

Rising domestic demand and improving labor-management relations led to 10.6 percent growth in total auto production for the first half of 1990 over the same period last year. During the six month period, 584,926 units were produced, and the year-end target of 1.3 million units, or a 15 percent increase over last year, seems attainable.

Steel: Korea's iron and steel industry continued to grow during the first half of 1990, with crude steel production up 7.5 percent totalling 11.3 million tons. This growth rate was half of that for the same period of 1989, reflecting slowing demand from such major steel consuming industries as automobiles and electronics. Domestic demand for rolled steel products increased to 9.6 million tons, a 16.3 percent gain over the same period of 1989. Much of this increase was due to the healthy construction industry; demand for steel bar, used in construction, increased 38 percent over the same period of 1989, accounting for 49.7 percent of total rolled steel products. In contrast, demand for steel sheet and plate declined by 0.1 percent over the same period of 1989 resulting in excess inventories.

Imports of rolled steel increased 7 percent over the same period of 1989 as the government temporarily reduced tariffs on steel bar to ease domestic shortages.

Korea exported 3 million tons of steel in the first half of 1990, a 4 percent gain over the same period of 1989. The slow growth in exports stemmed from reduced demand in the United States and Japan, the ROKG's decision to restrict the export of steel bars, and weakened competitiveness due to the won's appreciation vis-a-vis the yen. Exports to Japan accounted for 41 percent of total Korean steel exports, while exports to the U.S. made up 18 percent. During the first half of 1990, Korean exports to the United States utilized only 25.5 percent of its voluntary restraint agreement quota.

Industry forecasts for the steel industry in the second half of 1990 are optimistic, predicting reduced steel inventories, a stronger yen and increased export competitiveness, increased supply of steel bar, continued healthy performance of the construction and shipbuilding industries, and improved automobile and electronics industries. Industry analysts expect crude steel production to increase 6.5 percent for the year. In 1990, domestic sales, exports and imports of rolled steel products are expected to increase by 15 percent, 4.8 percent, and 10.7 percent respectively over 1989.

Tourism: During the first six months of 1990, Korea's international surplus in tourism revenues narrowed to \$175 million from \$584 million for the same period of 1989.

During the first half of 1990, 1.4 million foreign tourists visited Korea, up 6.7 percent over the same period of 1989. Tourist receipts totalled \$1.7 billion, a 5.9 percent drop from the same period of 1989. Per capita spending averaged \$1,191, a 11.9 percent reduction over the same period of 1989. Japanese visitors increased 3.6 percent to 665,112, accounting for 54.4 percent of the total; Americans decreased 4.9 percent to 129,818, representing 10.6 percent of the total.

A total of 725,547 Koreans traveled overseas during the first six months of 1990 spending \$1.5 billion, a 33.2 percent increase in tourist numbers and a 25.8 percent increase in expenditures over the same period of 1989. Per capita spending averaged \$2,052, a 6 percent drop over the same period of 1989. Japan was the primary destination for Korean travelers, accounting for 52 percent of the total, America was second with a 14.6 percent share.

Through December 1990, three million foreign tourists to Korea are expected to spend around \$3.9 billion, while 1.6 million Koreans are estimated to travel abroad spending \$3.5 billion.

IMPLICATIONS FOR U.S. BUSINESS

After several years of steady improvement in the climate for foreign business in Korea, U.S. companies' efforts to sell in the Korean market were set back with the initiation of an austerity campaign in mid-1990. The campaign, which was triggered by Korean perceptions of weakening export performance and inequities in income distribution (with particular reference to those recently enjoying "unearned" income from speculation in real estate and other assets) put a halt to sales of many imported consumer goods, a number of which had only had only recently been liberalized. The campaign has been accompanied by public protests against the purchase of "luxury" imports, the removal of foreign products from department store

shelves, and threats of tax audits for those purchasing foreign autos or spending excessively on foreign travel. The government denies involvement, and in late November the Deputy Prime Minister indicated publicly that an anti-import bias in the campaign is inappropriate. However, there has also been a resurgence of problems in other areas, such as continued harassment of American cigarette companies and American film distributors, the proposed slowdown in the planned tariff reduction plan, and delays in service sector liberalization. Taken together, these developments suggest that promised efforts to further liberalize Korea's market have stalled. The U.S. Government will continue to monitor developments and to work for meaningful market access for U.S. exporters and investors.

U.S. Export Prospects: In 1989, U.S. merchandise exports to Korea reached \$15.9 billion, a 25 percent increase over 1988. Although the improved price competitiveness of U.S. exports resulting from won appreciation contributed to the increase, the Korean government's strategy of diversifying imports was also a key factor.

Despite continued barriers to free trade, Korea offers excellent opportunities for U.S. exporters. There is a strong demand for U.S. industrial raw materials, heavy machinery, factory automation equipment, pollution control equipment, services and technology, electronics, and high-technology scientific products. Korean manufacturers recognize that in order to upgrade the quality of their products and arrest rising production costs they must acquire more advanced production equipment. U.S. firms can compete very effectively in Korea for sales of products such as medical equipment and supplies, communications equipment, analytical and scientific instruments, electronic industry production and testing equipment, electronic components, food processing and packaging equipment, industrial controls, special machine tools, and special-purpose computers and peripherals. However, in view of Japan's proximity, aggressive marketing and strong after-sales service are essential. Korea will continue to be a major market for U.S. agricultural commodities as well as industrial materials such as coal, chemicals, scrap metals, logs, and lumber.

The Korean Government will soon embark on a series of major infrastructure projects which may offer U.S. firms the opportunity to provide engineering services and to compete for equipment sales. These projects include: a new international airport near Seoul (1990-1993); a high-speed railway line between Seoul and Pusan (1991-1998); and an east-west high-speed electric railway line between Seoul and Kwang-noong (1991-1996). The total cost of these three projects is estimated at \$10 billion. In addition, large-scale expansion

of the container handling facilities of the ports of Pusan and Kwangyang is scheduled to begin in the early to mid-1990s. The four Korean oil refineries including Yukong, Honam Oil and Kyung-In Energy have plans to make an estimated total investment of \$3 billion through 1992 to raise their total daily refining capacity from the present 840,000 barrels to 1,235,000 barrels.

Licensing and technical assistance agreements provide an alternate means of entry into the Korean market for U.S. exporters. In 1989, Korean companies signed 763 technical licensing agreements with foreign firms, a 2 percent increase from the 751 agreements reached in 1988. The electronics and electrical machinery sector accounted for the largest share of these agreements (27 percent), followed by machinery (21 percent). U.S. companies accounted for 244 of the licensing agreements concluded in 1989 (up from the 168 agreements concluded in 1988), while Japanese firms signed 354 such agreements (up from the 343 agreements reached in 1988).

Royalty payments by Korean firms increased substantially in 1989. During 1989, royalties paid by Korean firms on technical licensing agreements with foreign companies totalled \$888.6 million, a 31.1 percent increase over the \$676.3 million recorded in 1988, or more than three times the 1984 level of \$213.2 million. The largest share of the payments, \$415 million, went to U.S. companies, while Japanese firms received \$273 million. In 1989, remittances of royalty payments averaged \$1,164,000 per case, more than double the 1984 level of \$487,900 per case.

For 1989, royalty payments amounted to \$888.6 million. The steady increase in royalty payments on the licensing of foreign technology reflects a shift to more technology-intensive production in response to the sharp increases in wage costs in recent years.

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